

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Washington, D.C.

In re

**Determination of Royalty Rates and
Terms for Transmission of Sound
Recordings by Satellite Radio and
“Preexisting” Subscription Services
(SDARS III)**

**Docket No. 16-CRB-001-SR/PSSR
(2018-2022)**

**SIRIUS XM’S MEMORANDUM IN RESPONSE TO THE JUDGES’ REHEARING
ORDER**

Pursuant to the Copyright Royalty Judges’ April 17, 2018 Order Granting in Part and Denying in Part Sirius XM’s Motion for Rehearing and Denying Music Choice’s Motion for Rehearing (the “Order”), Sirius XM Radio Inc. respectfully submits this memorandum to respond to the twin questions posed by the Judges: (i) “whether the 15.5% royalty rate is based on an ARPU that is not commensurate with the Gross Revenues definition actually adopted,” Order at 8; and (ii) if not, what ARPU should be used to convert the [REDACTED] per subscriber royalty that the Judges determined to be the applicable royalty into a percentage-of-revenue rate. Order at 8-9.

As we explain herein: (i) the [REDACTED] ARPU used by the Judges to derive the 15.5% royalty rate is unquestionably *not* commensurate with the going-forward definition of Gross Revenues adopted by the Judges; and (ii) when certain revenue and fee exclusions made by Sirius XM and reflected in the [REDACTED] ARPU figure are added back in to conform with the going-forward definition of Gross Revenues, the ARPU increases to [REDACTED]. When this corrected ARPU is substituted into the calculation made by the Judges to determine the SDARS

percentage-of-revenue royalty rate, the resulting rate decreases from 15.5% ([REDACTED] per-subscriber royalty / [REDACTED] ARPU) to 14.7% ([REDACTED] per-subscriber royalty / [REDACTED] ARPU).

The Underlying Calculation

In responding to the questions posed, it is useful to begin by setting forth the math that generated the currently applicable 15.5% royalty rate. The Judges' core rate determination, which is not at issue on the current motion,¹ was that a per-subscriber fee of [REDACTED] best reflects the reasonable fee to be paid by Sirius XM during the 2018-2022 license period. Since it was determined that that fee should be expressed as a percentage of Sirius XM's applicable Gross Revenues, the Judges required a measure of the average revenue per user (ARPU) earned by Sirius XM. The Judges selected [REDACTED] as the ARPU figure, yielding a 15.5 percent fee ([REDACTED]). There can be no dispute that in performing this math, the Judges intended to maintain the economic integrity of their core determination that the reasonable value of the license at issue is [REDACTED] per subscriber per month: it was plainly the Judges' intent to calculate a revenue percentage which, when applied to Gross Revenues as defined, would yield fees to SoundExchange equivalent to [REDACTED] per subscriber.

The Selection of [REDACTED] as the ARPU Figure

The [REDACTED] ARPU figure used by the Judges in their Initial Determination was calculated and first put forward by SoundExchange expert witness Jonathan Orszag. Mr. Orszag testified that he used the monthly statements of account reported by Sirius XM to SoundExchange from January to June of 2016 to arrive at this figure. Am. Written Direct Test. of Jonathan Orszag ¶

¹ Sirius XM maintains its disagreement with the determination (and its supporting rationale) that [REDACTED] is the correct per-subscriber fee and continues to reserve all rights to challenge that aspect of the Determination on appeal.

59, Trial Ex. 26 (“Orszag AWDT”). The revenues used by Mr. Orszag in his Amended Written Direct Testimony² are contained in the chart below (in millions of dollars):

	1/2016	2/2016	3/2016	4/2016	5/2016	6/2016	Total
Sirius XM Gross Revenues	██████	██████	██████	██████	██████	██████	██████

To convert these Gross Revenues into an average per-subscriber revenue figure, Mr. Orszag simply divided the total Gross Revenues for the six-month period by the daily weighted average subscriber count over the same six-month period: 30.044 million subscribers. Orszag AWDT ¶ 59, n.74, tbl. 3 & app. D. He then divided again by six to reach a monthly ARPU:

$$\text{Gross Revenues for Jan.-Jun. 2016 of } \text{██████████} / 30.044 \text{ million subscribers} / 6 \text{ months} \\ = \text{██████}$$

Why ██████ is the Wrong ARPU Figure for Purposes of Calculating the Applicable Revenue Percentage

The revenues reported by Sirius XM to SoundExchange for the first six months of 2016 necessarily only include the revenues that Sirius XM determined were reportable to SoundExchange as of that time. As relevant here, at that point in time, Sirius XM was excluding revenues attributed to the premium non-music programming included in its Premier and All Access packages as well as credit card fees (under the label “transaction” fees); as a result, those revenues and fees were *not* included in the revenue figures from which Mr. Orszag derived the ARPU of ██████.

² Orszag AWDT ¶ 59, tbl. 3 & n.73. More detail on how Mr. Orszag arrived at these Gross Revenues is provided in Appendix D to his Amended Written Direct Testimony.

The Judges have now ruled that revenues attributable to premium non-music programming in Sirius XM's Premier and All Access packages (as currently bundled and marketed) and credit card fees (which are not billed to subscribers) must be included in the Gross Revenues reported to SoundExchange over the 2018-2022 license period. Accordingly, the revenue categories that Sirius XM reported in 2016 that resulted in the [REDACTED] ARPU figure used by Mr. Orszag understate those that must be reported under the going forward definition of Gross Revenues adopted by the Judges. This means that in order to arrive at the correct percentage of revenue designed to generate equivalent fees to those that would result from charging Sirius XM [REDACTED] per subscriber, it is necessary to (a) calculate the appropriate ARPU figure taking into account the additional revenues that are now to be included in the Gross Revenue calculation, and (b) divide [REDACTED] by *that* revised ARPU. This approach to arriving at the correct revenue percentage payable has been accepted by the Judges and appears to be undisputed.³

Failure to make the foregoing adjustment would result in royalty payments well above the intended [REDACTED] level. 15.5% of [REDACTED] equals [REDACTED]. But if the reportable revenue base is

³ The Judges' Rehearing Order rightly recognized the need for this adjustment, noting that it "appears to [be] undisputed...that the ARPU used in the royalty rate ratio must be commensurate with the Gross Revenues definition that the Judges applied." Order at 8. That conclusion reflected the complete agreement between the parties and their respective expert economists as to the need to ensure that the ARPU used to convert the intended per-subscriber royalty of [REDACTED] into a percentage of revenue rate must match the going forward definition of Gross Revenues. *See, e.g.*, Corrected SXM Reply PFF ¶¶ 327, 392 & n.48, 394; 4/19/17 Tr. 212:5-213:21 (Shapiro); 4/20/17 Tr. 313:23-315:24 (Shapiro); Written Rebuttal Test. of Thomas Z. Lys ¶ 154, Trial Ex. 42 ("Lys WRT") ("[T]he revenue number used to calculate a percentage of revenue royalty rate should match Gross Revenues (the revenue base defined by the Judges)"); 4/25/17 Tr. 1000:12-1001:21 (Orszag) (testifying that if one were to apply a percentage royalty to an ARPU higher than that used to calculate the rate, it "would produce a per-subscriber rate that is too high" and agreeing with Professor Shapiro that "the ARPU that is used" in the rate derivation "should be consistent with the Judges' regulations defining what revenue is subject to percentage-of-revenue rate in this case").

larger than [REDACTED] as a result of including revenue categories not previously included, application of a 15.5% royalty rate necessarily will generate per-subscriber fees higher than the intended [REDACTED]. Instead of receiving fees at the level of the intended royalty of [REDACTED] per subscriber, the record industry would receive royalties of some [REDACTED] per subscriber, or additional fees of some [REDACTED] over the five year license period. *See* Order at 7-8; Sirius XM’s Reply in Support of its Motion for Rehearing at 2. As the Judges have recognized, such a result is manifestly unjust and at odds with the intent of the Initial Determination. Order at 7-8.

Calculating the Correct ARPU

Calculating the correct ARPU to be used to convert the per-subscriber rate into a percentage of revenue rate entails adding back into the revenue figures relied upon by Mr. Orszag those categories of revenues and fees previously excluded by Sirius XM that must be reported pursuant to the going-forward definition of Gross Revenue arrived at by the Judges. The means for doing so is found in Trial Exhibit 149 (attached hereto as Exhibit A), an exhibit (in native Excel format) offered by SoundExchange and admitted into evidence.⁴ Specifically, the information is found in the spreadsheet tab labeled “SX Summary Sep16,” which contains, in summary format, the relevant Sirius XM revenue information for each month from January to September of 2016. (The other tabs of the spreadsheet contain much more detailed financial information underlying the summary found on the “SX Summary Sep16” tab.)

⁴ Professor Thomas Lys, another SoundExchange expert witness, used this same exhibit to identify the Gross Revenues calculated by Sirius XM for the same six-month period January through June of 2016. *See* Lys WRT ¶¶ 157-58 & fig. 20 (referring to the document (Bates number SXM_DIR_00028243) as the “official Sirius XM document[] used as back-up for calculating royalties”).

Trial Exhibit 149 contains not only the total revenues that were reported to SoundExchange for the same January-June 2016 period used by Mr. Orszag to arrive at his [REDACTED] ARPU figure, but also the revenues and fees, category by category, that were *excluded* from Gross Revenues prior to being reported to SoundExchange during each month of this period (including the two categories that are at issue here). As a result, all of the additional information necessary to derive an appropriate measure of ARPU consistent with the going-forward definition is contained in this exhibit:

- the Gross Revenues for each of the six months used by Mr. Orszag to calculate the ARPU of [REDACTED] (listed in cells D44-I44 of the “SX Summary Sep16” tab of Exhibit 149);
- the previously excluded revenues attributed to premium non-music programming in Sirius XM’s Premier and All Access packages (listed under “Exclusions” in the same tab in cells S5-X5 (for self-pay subscribers) and S6-X6 (for subscribers in the promotional period paid by an automaker)); and
- the deductions that were taken for transaction fees during this six month period (listed under “Deductions” in the same tab in cells D37-I37).

Each of these items is highlighted in Exhibit B to this Memorandum, a printout of the relevant portions of the “SX Summary Sep16” tab of Trial Exhibit 149.

The chart below recalculates the Gross Revenues used by Mr. Orszag to include the previously excluded revenues (in millions of dollars):

	1/2016	2/2016	3/2016	4/2016	5/2016	6/2016	Total
Gross Revenues Calculated by Sirius XM in 2016 ⁵	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

⁵ These figures differ very slightly from those used by Mr. Orszag to calculate his [REDACTED] ARPU because Mr. Orszag, at the time of completing his written direct testimony, did not have access to the detailed information in Trial Exhibit 149. As explained in his written testimony, he instead worked from the bottom-line revenues reported in the statements of account provided to

	1/2016	2/2016	3/2016	4/2016	5/2016	6/2016	Total
+ Premier Revenues Excluded in 2016 (Self-Pay)	■	■	■	■	■	■	■
+ Premier Revenues Excluded in 2016 (Promotional)	■	■	■	■	■	■	■
+ Credit Card Transaction Fees Deducted in 2016 ⁶	■	■	■	■	■	■	■
= Gross Revenues Reportable Pursuant to the Going-Forward Definition	■	■	■	■	■	■	■

The final row of this chart, the Gross Revenues reportable pursuant to the going-forward

definition, reflects the revenues used in Mr. Orszag's ARPU calculation (Sirius XM's ■■■■■■

■■■■■ in Gross Revenues for Jan.-Jun. 2016) plus the previously excluded Premier Revenues

SoundExchange from Sirius XM each month; this required him to estimate and then “back out” the deduction made by Sirius XM to account for its performances of pre-1972 sound recordings and directly licensed sound recordings, which was not displayed on the report forms. *See Orszag AWDT ¶ 59 n.73 & app. D.* No such approximation is necessary when working directly from Trial Exhibit 149, which displays Sirius XM's actual Gross Revenues prior to adjustment for pre-1972 and directly licensed performances. (For this reason, Professor Lys's Written Rebuttal Testimony identifies and relies on the same Gross Revenues as set forth by Sirius XM in the chart above based directly on Trial Exhibit 149. *See Lys WRT ¶¶ 157-58 & fig. 20*).

⁶ To be precise, the figures in this row include all the Transaction Fees identified in Trial Exhibit 149 except the “Sale & Use Tax” portion which, under the revised Gross Revenue definition, remains excludable (unlike the credit card fees). The amount of this tax is found at cells C15-H15 of the “Transactions Fees” tab, which provides the underlying transaction fee data that the Excel file draws from to calculate the transaction fees identified in the “SX Summary Sep16” tab. (This can be seen by clicking on the transaction fees on the “SX Summary Sep16” tab and following the identified tab and cell references back to the “Transactions Fees” tab.) As can be seen on the “Transactions Fees” tab, the Sales & Use Tax comprises an immaterial amount (<1%) of the total transactions fees, the remainder of which are credit card and collection expenses that are no longer excludable.

for Self-Pay Subscribers [REDACTED] **plus** the previously excluded Premier Revenues for Promotional Subscribers [REDACTED] **plus** the previously deducted credit card Transactions Fees [REDACTED] that now must be included, resulting in a revised total of [REDACTED].

When these revised revenues for the period January-June of 2016 are stated on a per-subscriber basis – following the precise approach used by Mr. Orszag – the resulting ARPU is [REDACTED]:

$$\text{Gross Revenues for Jan.-Jun. 2016 of [REDACTED] / 30.044 million subscribers / 6 months} \\ = \text{[REDACTED]}$$

Calculating the Proper Revenue Percentage Payable by Sirius XM

The recalculated ARPU of [REDACTED] must be used to satisfy the requirement that the ARPU used to convert the [REDACTED] per-subscriber royalty into a percentage-of-revenue rate be consistent with the going-forward definition of Gross Revenues. When this corrected ARPU of [REDACTED] is used in place of the [REDACTED] ARPU figure calculated by Mr. Orszag, the resulting SDARS royalty rate declines from 15.5% [REDACTED] to 14.7% [REDACTED]).

CONCLUSION

For the foregoing reasons, and for those addressed in Sirius XM's Motion for Rehearing, Sirius XM respectfully requests that the Judges correct for the use of an improper measure of ARPU, and reduce the SDARS royalty rate for the 2018-2022 license term from 15.5% to 14.7% in their Final Determination.

Dated: May 15, 2018

Respectfully submitted,

/s/ Todd D. Larson

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EXHIBIT A

Restricted

EXHIBIT B

Restricted

CERTIFICATE OF SERVICE

I hereby certify that on May 15, 2018, I caused a copy of the PUBLIC version of Sirius XM's Memorandum In Response To The Judges' Rehearing Order and accompanying Declaration of Todd Larson and Redaction Log, to be served by email to the participants listed below:

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Certificate of Service

I hereby certify that on Tuesday, May 15, 2018 I provided a true and correct copy of the Sirius XM's Memorandum In Response To The Judge's Rehearing Order to the following:

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Signed: /s/ Todd Larson